E-002/GR-92-1185 ORDER SETTING INTERIM RATES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Petition of Northern States Power Company for Authority to Increase Rates for Electric Service in Minnesota	ISSUE DATE: December 31, 1992 DOCKET NO. E-002/GR-92-1185 ORDER SETTING INTERIM RATES

PROCEDURAL HISTORY

On November 2, 1992, Northern States Power Company (NSP or the Company) filed a petition seeking a general rate increase of $119 million, or approximately 9%. Along with the rate increase petition, the Company filed a proposed interim rate schedule to go into effect on January 1, 1993. This schedule provided for a $75,330,000 or 5.68% increase over the rates established in NSP's most recent rate case. This schedule, however, was modified by the Company in a December 3, 1992 filing, which reduced the requested interim increase to $74,752,000 or 5.63%. The modified filing excludes incentive compensation expenses consistent with the Commission's treatment of these expenses in NSP's last rate case.

On December 14, 1992, the Commission issued its NOTICE AND ORDER FOR HEARING, in which the Commission referred the general rate case to the Office of Administrative Hearings for contested case proceedings. Also on this date the Commission issued its ORDER ACCEPTING FILING AND SUSPENDING RATES. Having suspended the Company's proposed rates, the Commission must set an interim rate schedule within 60 days of the Company's initial rate petition.

The Company's proposed interim rates came before the Commission for consideration on December 21, 1992.

FINDINGS AND CONCLUSIONS

I. INTERIM RATE STATUTE

Interim rates are governed by Minn. Stat. § 216B.16, subd. 3, which provides in relevant part:

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> Unless the commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; (2) rate base or expense items the same in nature and kind as those allowed by a currently effective order of the commission in the utility's most recent rate proceeding; and (3) no change in the existing rate design.

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I. COMPANY PROPOSAL

NSP's proposal, as modified in the Company's December 3, 1992 filing, provides for an interim rate increase of $74,752,000, based on the following revenue summary (000's omitted):

Rate Base	$2,395,259
Rate of Return	9.90%
Required Operating Income	237,131
Net Operating Income	92,631
Income Deficiency	44,500
Revenue Conversion Factor	1.679825
Revenue Deficiency	74,752

This represents an increase of 5.63% over NSP's current rates. The increase excludes the compensation expenses that the Company inadvertently included in its initial filing on November 2.

II. RATE BASE AND EXPENSE ISSUES

As indicated above, rate base or expense items must be the same in nature and kind as those allowed by a currently effective order of the Commission in the utility's most recent rate proceeding, absent exigent circumstances. The Company's proposed interim rates include the full amount of its projected test year rate case expenses (approximately $869,000). NSP maintains that this is consistent with the Commission's treatment of these expenses in the Company's last rate case. In that instance, the Commission allowed NSP to reduce its refund at the end of the rate proceeding by the full amount of its test year rate case expenses.

The Commission finds that the inclusion of rate case expenses in interim rates in this proceeding would be inappropriate. These expenses were not included in the final rates in NSP's previous rate case. Instead, the Commission granted a one time reduction in NSP's customer refund to recoup these expenses. The Commission considers it essential to postpone any decision on rate case expenses until after the issue has been fully developed in the proceedings to determine the Company's final rates. When the issue has been fully developed on the record the Commission will be in a better position to determine the extent to which the Company's rate case expenses should be recoverable and the manner in which they should be recovered.

Coal Reclamation

NSP has various contractual obligations that require the Company to pay certain coal mine reclamation costs. NSP has started an internal fund to pay approximately 55% of the annually accrued reclamation costs for the Westmoreland mine. The balance of these costs is recovered through the fuel clause.

The Westmoreland fund did not exist when the Commission deliberated the Company's last rate case. The fund reflects an allocation method required by the Federal Energy Regulatory Commission (FERC). Coal reclamation is a normal cost of NSP's operations and, as such, should be included in the Company's interim rates. Although a fund of this kind was not specifically included in NSP's previous rate case, the Commission finds that the new allocation method compelled by FERC constitutes an exigent circumstance, allowing the inclusion of the fund in the Company's interim rates. The Commission emphasizes that this cost will be subjected to the usual review before it can be included in the Company's final rates.

Other Expense Items

All other expense items included in the Company's proposed interim rates, including those associated with the Conservation Improvement Program (CIP) and Demand-Side Management Financial Incentives, appear to be the same in nature and kind as the expenses allowed in the Company's previous rate case. The Commission approves the inclusion of these expenses for interim rate purposes, but notes that all of these expenses will be subject to review before final rates are approved.

III. INTERIM RATE OF RETURN

NSP proposes the following capital structure and cost rates for interim rates:

Type of Capital	Ratio	Cost	Weighted Cost
Long Term Debt	38.66%	8.49%	3.30%
Short Term Debt	4.36%	5.92%	0.26%
Preferred Stock	8.28%	5.75%	0.47%
Common Equity	48.50%	12.10%	5.87%
Total	100.00%		9.90%

Rate of Return on Common Equity

As indicated above, interim rates must include a rate of return on common equity "equal to that authorized by the Commission in the utility's most recent rate proceeding," absent exigent circumstances. Minn. Stat. § 216B.16, subd. 3 (1992). The Company's proposed rate of return on common equity is 12.10%, which is identical to the rate of return approved in NSP's last rate case. The Commission does not find any exigent circumstances that would compel a different rate of return at this point in the proceeding.

Capital Structure

The Company's proposed capital structure includes a 48.50% equity ratio for both interim and final rates. This is 0.75% higher than the 47.75% ratio approved by the Commission in NSP's last electric rate case. The Commission finds the Company's proposed equity ratio inappropriate for interim rate purposes.

The statutory requirement of basing interim rates on the proposed test year cost of capital does not include accepting the precise mix of capital sources proposed by the Company. The Commission explained this in its December 29, 1992 ORDER SETTING INTERIM RATES, Docket No. E-002/GR-89-865, stating the following in reference to the statutory requirement:

> [T]hat requirement applies to the costs assigned to various sources of capital, not to the balance between the sources of capital themselves. To hold otherwise would allow the Company to circumvent important policy decisions carefully reached after full contested case proceedings. It would seriously impair the Commission's ability to carry out its supervisory functions over public utilities. It would adversely affect the public interest by allowing rates to be calculated on the basis of a capital structure the Commission has found to be unjust and unreasonable for ratemaking purposes.

Equity is the most expensive means of financing a Company. Therefore, the Commission has always scrutinized the reasonableness of a Company's equity ratio carefully in general rate proceedings. The Commission is particularly reluctant to approve an equity ratio for a utility's interim rates that is higher than the one established previously. A utility's existing equity ratio rests on important policy considerations deliberated carefully in the utility's previous rate case. An interim increase in a utility's equity ratio is a significant change to make without the benefit of a fully developed record. The Commission sees no reason to increase the Company's equity ratio at this point in the process. The Commission will review the equity ratio in the course of its rate case proceedings. These proceedings will allow the Commission to fully reevaluate the decisions and assumptions underlying the previously established ratio.

The Commission rejected proposed increases in the equity ratio for interim rates in two previous NSP electric rate cases. See In the Matter of the Application of Northern States Power Company for Authority to Increase its Rates for Electric Service in Minnesota, Docket No. E-002/GR-87-670, ORDER SETTING INTERIM RATES (December 29, 1987); and In the Matter of the Application of Northern States Power Company for Authority to Increase its Rates for Electric Service in Minnesota, Docket No. E-002/GR-89-865, ORDER SETTING INTERIM RATES (December 29, 1989). The Commission accepted NSP's proposed equity ratio for interim rates in the Company's 1991 rate case. That proposal, however, did not increase the ratio above the level established in the Company's previous rate proceeding. Consistent with these past decisions, the Commission finds that the current equity ratio of 47.75% is appropriate for the Company's interim rates in this proceeding.

With respect to the disallowed equity portion (0.75%), the Commission will treat it the same way it treated the disallowed portion of the equity ratio in the Company's 1987 and 1989 electric rate cases. See Docket No. E-002/GR-87-670, ORDER SETTING INTERIM RATES (December 29, 1987); and Docket No. E-002/GR-89-865, ORDER SETTING INTERIM RATES (December 29, 1989). The Commission will reclassify the 0.75% as long term debt and apply a current cost of long-term debt (the 5.875% coupon rate on NSP's first mortgage bond issue of October 19, 1992) to the 0.75% disallowed equity. The resulting overall rate of return will be 9.85%.

IV. INTERIM RATE DESIGN

NSP proposes to collect its interim rate increase equally from all customer classes by applying the same percentage surcharge to each retail rate schedule. The Commission accepts the Company's proposal for allocating the increase among customer classes since the proposal is consistent with Commission policy and with Minn. Stat. § 216B.16, subd. 3, which prohibits any change in existing rate design in interim rates absent exigent circumstances. The Commission finds nothing in the circumstances of this proceeding that would compel a change in rate design for interim rate purposes.

V. COMMISSION ACTION

Based on the findings and conclusions above, and after incorporating the related cash working capital and interest synchronization effects, the Commission will authorize an interim revenue increase of $71,158,000, or 5.36% of revenues under current rates. The increase granted herein does not include the rate case expenses contained in the Company's proposal. The interim rate schedule will be effective on January 1, 1993. The revenue increase is based on the following revenue summary (000's Omitted):

Rate Base	$2,395,267
Rate of Return	9.85%
Required Operating Income	235,933
Net Operating Income	193,573
Income Deficiency	42,360
Revenue Conversion Factor	1.679825
Revenue Deficiency	71,158

Interim rates are collected subject of refund in the event the interim rate level exceeds the final rate level allowed in the general rate case. Minn. Stat. § 216B.16, subd. 3.

ORDER

1. Northern States Power Company is authorized to collect $71,158,000 in additional annual revenues, or 5.36% of revenues under current rates. The interim rate schedule will be effective on January 1, 1993.

2. The interim rates shall not include any portion of the Company's rate case expenses. The matter of rate case expenses shall be taken up in the final rate proceeding.

3. The Company's proposed interim rate capital structure shall be adjusted to apply the currently authorized common equity ratio of 47.75%. The Company shall apply the current cost of long term debt, 5.875%, to the disallowed equity portion of its capital structure.

4. The Company is authorized to allocate the interim increase among customer classes as proposed in its filing.

5. The Company shall file with the Commission and the Department of Public Service interim tariff sheets reflecting the Commission's decisions. This filing shall be made within seven days of the date of this Order.

6. The Company shall provide notice of the approved rate changes with the first billing under interim rates.

7. The Company shall keep such records of sales and collections under interim rates as would be necessary to compute a refund.

8. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

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